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IN THE

# Supreme Court of the United States

OCTOBER TERM, 1951.

No. 613

JEAN G. L. CASSEL VAN DOORN and
MARIJ V. CASSEL VAN DOORN,

*Petitioners,*

*v.*

WILLIAM HENIG, Trustee in Bankruptcy of
Regency, Inc., Bankrupt,

*Respondent.*

## PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT.

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Petitioners pray that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Third Circuit, entered in the above case (entitled Regency, Inc., Bankrupt.) on December 5, 1951.

### Opinions Below.

The memorandum opinion of the referee in bankruptcy (R. 99a) is unreported. The opinion of the District Court (R. 110a) is reported in 96 F. Supp. 535. The opinion of the Circuit Court of Appeals (R. *175*) is reported in 192 F. 2d 574.

## Jurisdiction.

The judgment of the Circuit Court of Appeals was entered on December 5, 1951 (R. 176). The jurisdiction of this Court is invoked under 28 U. S. C., Section 1254 (1).

## Questions Presented.

1. In a bankruptcy case should an admitted claim of an officer of the bankrupt corporation be subordinated to the claims of other creditors because he was the dominant and controlling factor in the corporation's affairs when his claim is not conceived or nurtured in fraud and no benefit accrued therefrom to him?

2. Where the effect of subordination is to make such officer personally liable for the corporation's debts, is the bankruptcy court bound to recognize as *res judicata* a decision of the state court, between the same parties, holding that the officer is not personally liable for the corporate debts?

3. Where such controlling officer-creditor causes the debtor corporation to transfer its assets to him in part payment of his claim and, thereafter, a state court determines that such transfer was in violation of creditors' rights and directs restoration of the assets which is forthwith done, does not the bankruptcy law permit him to share equally with other creditors notwithstanding his participation in the void transfer?

## Statutes Involved.

The pertinent sections of the bankruptcy law are set forth in the Appendix *infra* (p. 1a).

## Statement of the Case.

The issue herein involved arises upon distribution in the bankruptcy case of Regency, Inc., initiated in the United States District Court for the District of New Jersey by a voluntary petition on April 28, 1948 (R. 1a). The assets which finally came into the possession of respondent, the trustee, consisted of land and buildings of the bankrupt corporation and $25,000 in cash (R. 72a-73a). The land and buildings were duly sold by respondent for $90,000, so that he has on hand $115,000 in cash for distribution to creditors (R. 77a).

An amended general claim was filed with the Referee by Jean G. L. Cassel van Doorn, petitioner, for $290,675.79 for cash advanced to the bankrupt (R. 8a). Marij V. Cassel van Doorn, his wife, also a petitioner, filed a claim for $8,796.35 for cash she advanced (R. 4a). Three other claims have been filed, one by John S. Westervelt's Sons, a judgment creditor, for approximately $23,000 for labor and materials and two disputed claims aggregating approximately $2,000 (R. 150a).

On objections filed by respondent and after hearing, the Referee allowed the claims of petitioners but subordinated them to the other claims (R. 103a). He was affirmed by the District Court (R. 111a) which in turn was affirmed by the Circuit Court (R. 176 ).

Regency, Inc., the bankrupt, was incorporated under the laws of the State of New Jersey on May 15, 1941. Marij V. Cassel van Doorn was the subscriber to all of the five hundred shares of the capital stock for which she paid $50,000 in cash to the corporation (R. 100a). She allowed one share to be held by her husband and one by their attorney as qualifying shares (R. 100a). The facts leading up

to and following the incorporation of the bankrupt were delevoped at the first meeting of creditors.

Baron Cassel van Doorn and his wife are Europeans with a long background of wealth, culture and taste. They rescued a substantial part of their fortune from war-torn Belgium and came to America in 1940. The van Doorns conceived an ambitious, albeit impracticable, program for entry into the commercial world of this country. The Baron had always been a great lover of and authority on antiques although he had never been in the business for profit (R. 59a). Taking a leaf from the book of some of the commercially successful antiquarians, he planned a pretentious showplace near New York in which various rooms would be paneled and furnished to authoritatively represent periods of European antiquity and therein display for possible customers the items he had for sale (R. 67a). Such place would also be his home to which he would invite people of means to parties, dinners and as house guests and thus indirectly show off his wares even to the extent of interesting people in the purchase of whole rooms and balconies, mantle pieces and paneling imported from Europe. The actual business of buying and selling would then be conducted from an office in New York City (R. 67a-69a).

Regency, Inc., was intended to be and was a close corporation. Its principal purpose was to buy and sell antiques. Its capital of $50,000 was paid in and an old residence at 240 Broad Avenue, Englewood, New Jersey, was purchased for $50,000, title being taken in the corporate name. The deeds were dated December 26, 1941, and were duly recorded (R. 49a, 114a, 115a).

The next step in the overall plan was to alter and improve the property so that it would conform to the purposes for which the corporation was formed. This neces-

sitated considerable expenditure of money. An architect was employed (R. 147a) and various contracts were entered into. The Baroness advanced to the corporation as a loan, cash totalling $71,106.33 (R. 113a, 149a). The money so loaned was disbursed by the corporation as the construction work progressed. As more money was needed the Baron advanced it but the circuitous method of paying his money into the corporation account and then having the corporation pay the contractors was abandoned (R. 148a). He paid the contractors directly, charging the amounts, however, as loans to the corporation. One of the contracts was with John S. Westervelts' Sons, Inc. on a cost-plus basis. In March or April of 1943, after Westervelt had been paid $42,588.21 on its contract, (R. 92a) a final bill was presented to the corporation for $18,908.37 (R. 121a). The corporation concluded that the amounts charged by Westervelt were exorbitant and unfair. It refused to pay the bill and on November 10, 1943, Westervelt sued the corporation in the New Jersey State court.

During the pendency of this suit, a meeting of the directors of Regency, Inc., was held on January 29, 1945. At this time the assets and liabilities of the corporation were calculated and valued. The liabilities included the claim of van Doorn in the sum of $270,405.78 for moneys advanced by his wife and himself (his wife having assigned her part of the claim to him) and an additional claim for $20,050.00 for cash advanced by him in connection with the purchase of the so-called van Keuren and Loomis properties, additional land acquired by the corporation on June 19, 1942, and April 16, 1943, respectively (R. 151a-152a). Westervelt's claim, in suit, with costs and interests, if successfully prosecuted against the corporation, would amount to approximately $23,000 and there were two other

disputed claims totalling approximately $2,000. All other creditors were then or later paid (R. 150a). The assets consisted of the land and improvements.

The corporation ratified the corporate indebtedness to van Doorn and fixed the value of the property at $129,233. The corporation then transferred the property to van Doorn in consideration of a credit on his claim in said amount. This deed was dated January 29, 1945, and was forthwith recorded (R. 116a, 138a).

On February 16, 1948, Westervelt recovered a judgment against the corporation for $23,103.90, together with $78.97 taxed costs, after more than four years litigation (R. 121a). Westervelt, now a judgment creditor of the corporation, on March 28, 1948, filed a state chancery action to set aside the transfer of the property to van Doorn, alleging that said transfer was in violation of a New Jersey statute identified as R. S. 14:14.2 which holds as void a conveyance made in contemplation of insolvency (R. 164a). It was also contended that plaintiff was entitled to a money judgment against van Doorn (R. 164a) on the theory that the corporation and van Doorn were one and the same, and that the corporation was but a sham and a shield for van Doorn, its *alter ego*.

On April 27, 1948, the corporation filed its voluntary petition in bankruptcy and respondent, the trustee, upon order of the bankruptcy court, became a party to the chancery proceedings and joined in the prayers of the plaintiff (R. 3a, 131a). The court ordered a reconveyance of the property to respondent for the benefit of all creditors but refused to pierce the corporate veil and subject van Doorn to personal liability for the corporation's debts (R. 165a).

Upon the entry of final judgment in this State Court action, van Doorn, in compliance with the decree of the court, conveyed the main property to respondent (R. 171a).

He had sold the so-called van Keuren and Loomis tracts in the meantime for $25,000, which sum he paid in cash to respondent.

Van Doorn had, theretofore, filed his claim in the bankruptcy case for $161,442.79 which gave credit in the amount of the valuation of the property transferred to him. When he reconveyed the property, his claim was amended to include the full amount advanced by him without the credit, said amended claim then amounting to $290,675.79.

Respondent then had the main property and $25,000 cash (R. 72a, 163a, 167a). He sold the property to van Doorn for $90,000 pursuant to an order of the Referee (R. 77a), thereby creating a fund of $115,000 for distribution to creditors. The Referee allowed petitioners' claims but subordinated them to the claims of other creditors which order of the Referee presents the issue in this case.

## Reasons for Granting the Writ.

1. A basic objective of the bankruptcy law is equality amongst creditors. It is recognized, however, that certain claims are entitled to priority in payment because of the nature of the debt. It is also recognized that certain claims should be subordinated to the claims of other creditors because to allow the claim to share equally would be unfair. Whereas those claims that are entitled to priority are specifically identified by the statute, there is no such expressed legislative intent with respect to subordination and the claims that should be subordinated must be determined by the application of general equitable principles. Accordingly, subordination is not a too clearly defined exception to the mandate of equality and, therefore, should be cautiously adjudged.

Cases of subordination arise generally in a contest between creditors not connected with the bankrupt and a creditor or creditors who are at the same time officers, directors or stockholders of a bankrupt corporation. In the leading case of *Pepper* v. *Litton,* 308 U. S. 295, 60 S. Ct. 238 (1939) this Court held that to allow the claim of an officer of the bankrupt company to share equally with other creditors would be unfair inasmuch as he had, in the first instance, created a questionable claim and then used his controlling position to secure and retain assets of the company while still asserting his claim against the bankrupt estate.

This case has been cited many times in support of or against the right of subordination. Factual circumstances are never identical, seldom similar, but in most of the cases where subordination was decreed the claim of the officer was conceived and nurtured in fraud as it was in the *Pepper* case. A few of these cases are cited in the argument following in support of the merits of petitioners' case. But there is a trend in the lower courts, as evidenced by the decision in the instant case, to decree subordination if claimant is the dominant and controlling factor in the corporation's affairs *irrespective of fraud.* On the other hand, the recent decision of the Circuit Court of Appeals for the Second Circuit, in *Swartz* v. *Mills,* 192 F. 2d 727, refused subordination of an officer's claim in connection with the selection of a trustee in the *absence of fraud.* A further review of the principles involved may be advisable to resolve an apparent conflict.

2. The rule of *res judicata* is involved in this case and becomes particularly important because the question is whether or not the bankruptcy court may disregard a decision of a state court. The state court decided, in an

action in which the petitioners and respondent were parties, that the creditors of Regency, Inc., could look only to the assets of the company for payment and that petitioners were not personally responsible. The state court refused the contention of respondent that petitioners and the corporation were one and the same and that the corporation was a sham and the *alter ego* of the controlling stockholder. The action in the state court was commenced by the judgment creditor of Regency, Inc., but upon the bankruptcy of Regency, Inc., and the appointment of a trustee (the respondent herein), he joined in that suit and prosecuted it to a conclusion on behalf of creditors. The circumstances under which respondent intervened in that case, the claims presented and the decision of the court are detailed in the following argument. Suffice it to say at this point that the judgment of the state court restored the property to the bankrupt estate but the court refused to "pierce the corporate veil", and make petitioners personally responsible to creditors.

While it is not now argued that the exact issue of subordination was before the state court, it is certainly crystal clear that the subordination of petitioners' claims in the bankruptcy case has the effect of requiring them to personally pay the other creditors' claims. The whole theory of subordination in this case is based upon the factual inference that the company and petitioners are the same. It is respectfully submitted that that issue has been decided by the state court to the contrary.

This Court has clearly stated that the principle of *res judicata* must be recognized in the administration of a bankruptcy case. In *Pepper* v. *Litton, supra,* the point was argued and the Court so held but found that the state court issue was entirely different from the issue in the bank-

ruptcy case. On the other hand, in *Heiser* v. *Woodruff*, 327 U. S. 726, 66 S. Ct. 271, (1945) the Court refused to allow subordination of a claim in bankruptcy upon a showing by the trustee that the claim was based upon perjured testimony because the merits of the claim had been tried in a state court proceeding and decided in favor of the claimant.

3. It is further submitted that a clearer understanding of the meaning of Sections 57g and 57n (Appendix p. 1a) is important. These sections provide that when a creditor has taken property of the bankrupt in violation of the rights of other creditors, he may not claim further relief in the bankruptcy court. If, however, having obtained such a voidable transfer, he restores it, he may then assert his claim on an equality with other creditors. Full restitution has been made in this case by petitioner Baron Cassel van Doorn, the other petitioner herein joining in the deed to Respondent to release her dower interest, but both petitioners have been denied equality with other creditors.

The purpose and meaning of Section 57n is forthrightly stated in 3 Collier, Sec. 57.19, page 241. It is there said

> "• • • what hinders allowance is not so much the preference itself as *the failure to surrender it.* (Italics ours) This apparently formalistic distinction is of great practical significance. It reveals the purpose, the meaning and the limited scope of Section 57g, which may best be summarized in the words: "*restoration, not punishment, is the object of this law.*" In none of its various shapes since the Act of 1898 has sub-division g been intended to declare a forfeiture or impose a penalty. Its strictly practical approach, free from moralizing discriminations, is evidenced by the fact that it does not exclude from its application fraudulent transferees, whether the fraud be constructive or actual. • • •"

Subordination is punishment. Respondent has continually stressed petitioner's abortive attempt to obtain payment of his claim as a basis for now deferring his right to share equally with other creditors. It is submitted that this is contrary to the spirit of the bankruptcy law.

## ARGUMENT.

### POINT I.

**All claims should share pro rata.**

At the outset let it be conceded that the bankruptcy court has the equitable power to subordinate one or more general claims of creditors to other general claims if in all fairness and good conscience the facts so warrant. This has been so decided in the leading case of *Pepper* v. *Litton, supra,* upon which respondent heavily relies. Whether petitioners are entitled to share *pari passu* with other general creditors of this bankrupt estate depends, therefore, upon whether or not such pro rata sharing would be fair. The underlying theory for subordinating their claims, as expressed in the *Pepper* case, is that a person closely connected with the insolvent cannot use his position or "power for his personal advantage and to the detriment of stockholders and creditors no matter how absolute in terms that power may be and no matter how meticulous he is to satisfy technical requirements." This would not be fair.

The facts in the *Pepper* case are very different from the facts in this case. There was shown a planned scheme to defraud creditors through a fictitious salary claim. Litton, the controlling officer of the company, caused the company to execute and deliver to him a judgment note for what purported to be five years back salary. This was done

pending a suit by a creditor. After the creditor obtained judgment, Litton executed upon the assets of his company, bought them in for a nominal amount and transferred them to another company exclusively owned by him. He created a questionable claim, secured and retained the assets of the company, and still asserted his claim against the bankrupt.

Upon consideration of these facts, this Court came to the conclusion that it could very well hold the officer's claim entirely without merit and disallow it but you said that irrespective of the validity of the claim as such, it should be subordinated to the claims of other creditors because it violated the "rules of fair play and good conscience". Then followed a statement of principles clearly applicable to a claimant the court considered dishonest and a fraud.

How different are the facts in this case. Not a single item in either of petitioners' claims was conceived or nurtured in fraud. Each item in the claims was conceded by respondent as representing moneys advanced by petitioners to bona fide creditors who had furnished labor and materials which went into the building owned by the corporation (R. 12a, 33a). $20,050 of the claim of van Doorn is for the money advanced to the corporation to acquire the van Keuren and Loomis land (R. 148a-149a, 115a-116a). When this land was subsequently transferred to van Doorn in 1945 along with the main building, he sold it for $25,000 and turned this $25,000 back to respondent in cash (R. 72a). Nothing for himself, but a profit for the bankrupt estate. And respondent is in possession of all the assets the company ever had. Van Doorn has nothing but what he bought from the estate at an approved sale for cash (R. 77a). It is submitted that the *Pepper* case turned on facts which were rampant with actual and premeditated fraud and the wrongdoer still retained the fruits of his fraud. Although

in the instant case there may have been some mistakes, there certainly was no actual fraud.

An important decision, often cited and approved is *Wheeler* v. *Smith,* (9th Cir., 1929) 30 F. (2d) 59. In that case, Wheeler, the claimant, became the sole stockholder of the Publishing Telegram Company. It was the practice of Wheeler, at his will, to withdraw moneys from said company but also to deposit moneys to the credit of said company. The balance of deposit over withdrawals formed the basis of Wheeler's claim.

The Court said:

> "The precise question of disallowance of the claim of a person owning all of the stock of a bankrupt corporation does not appear to have been heretofore determined. It is contended that as the corporation is a separate, legal entity, such claimant is entitled to the same consideration as any other creditor. While a few courts have held that a corporation should not be regarded as a separate entity where all the stock is held by one person, the weight of authority is to the contrary. 14 C. J. 52."
>
> "In the recent case of *Majestic Co.* v. *Orpheum Circuit,* 21 F. (2d) 720-724, the Circuit Court of Appeals for the 8th Circuit, citing many authorities, said: 'The corporation will be regarded as a legal entity as a general rule, and the Courts acting cautiously and only when the circumstances justify it, will ignore the fiction of corporate entity, where it is used as a blind or instrumentality to defeat public convenience, justify wrong or perpetrate fraud, and will regard the corporation as an association of persons."
>
> "Unless it can be said that the mere fact that Wheeler had acquired all the stock of the bankrupt corporation disentitles him to recover for loans or advances made to the company after such event, there is no justification for the deduction from his

claim of $35,000.00. It is conceded that no authority has been found for so holding."

In *Thoriot* v. *Plane,* (9th Cir., 1942) 126 F. (2d) 1015 the bankrupt was a corporation engaged in drilling for oil and gas. The outstanding stock was fully paid for. The capital of the bankrupt consisted of money paid in for its capital stock and land leased by it. At the time the creditors sold their goods and gave their services to the bankrupt, the oil field was undeveloped, and the credit of the bankrupt upon which the creditors relied was in part the development of the oil and gas wells with the services and materials they (the creditors) supplied. The claimant-appellant loaned $34,055.88 to the bankrupt for which he received the note of the bankrupt. The bankrupt had 14 stockholders. Appellant was one of these, owning 74% of the stock. He was also general manager of the bankrupt.

The Court (at p. 1016) held:

> "It is not claimed that the money he loaned to the bankrupt was not money used to the advantage of the bankrupt in the development of the oil and gas lease. In this situation it is clear that the case falls within the decision of this Court in *Wheeler* v. *Smith,* 30 F. (2d) 59, in which we held that even where the creditors owned all the stock of the corporation, which was operated solely for his benefit, he was entitled to recover on an equality with other creditors for the amount of his loan, *he having gained no advantage over the other creditors by reason of the loan* (Italics ours).

Criticizing and reversing the holding of the Referee and the affirmance by the District Court in subordinating the appellant's claim, the Court said further:

> "The reasoning for this extraordinary conclusion of the Referee and the District Court is that because

he (the claimant) would profit to the extent of 74% in the net results of the corporation's activities, if successful, his loan to the bankrupt must be regarded as not a loan but money advanced as a co-adventurer with the bankrupt. We cannot agree with this perversion of the admittedly honest administration of the bankrupt by the appellant. We can see no reason why, because owning 74% of the stock of the corporation and making gifts (free services, etc.) to it in aid of its corporate business which, if successfully accomplished, *would yield the assets on which all the creditors relied,* appellant should be put into a position of disadvantage with reference to the other creditors" (Italics ours).

In *Goldie* v. *Cox,* (8th Cir., 1942) 130 F. (2d), 695, the Court said at page 709:

"The fact situation here is as follows: Claimant was the majority stockholder, a director and officer and the dominating personality in the bankrupt. He was the dominant figure in the holding company which owned the land. He was the real force behind the promotion plan to improve the land by this building. The financing plan contemplated three methods of raising money to buy the land and to erect and furnish the building. The initial method was by Club membership fees which were to be turned over to the bankrupt when they reached a stated total. The other two methods were by sales of stock of the bankrupt and by the issue of bonds by it. The advancement and loans in these claims were (so far as we can judge from the incomplete evidence and with small exceptions) made to forward the enterprise by supplying money needed by the bankrupt, in connection with the project of building or of financing and not available to it from any of the three above sources. With the exception of the items (disallowed by the referee), there seems to be no dispute that they were used for such purposes. *The*

***advancement and loans seem to have been actually made; to have been made without overreaching so far as they were concerned; and to have been beneficial to bankrupt.***

"In the making of such advances and loans as found actually to have been made, *we find no such violation of 'rules of fair play and good conscience' toward the creditors, which would warrant these advances and loans being held to be capital contributions, and, as such to be subordinated to the claims of unsecured creditors.* We think the referee and trial court were in error in so holding." Citing Pepper *v.* Litton (Italics ours).

## POINT II.

**That the corporation is a separate entity is *res judicata.***

In *Heiser* v. *Woodruff, supra,* petitioner's claim in bankruptcy was based upon a judgment acquired against the bankrupt. Respondents objected to the allowance of the claim on the ground that, so far as there relevant, the judgment was procured by fraud and by perjured testimony as to the value of property alleged to have been converted by the bankrupt. The Referee disallowed the claim. The District Court allowed it, sustaining petitioner's contention that the issue of fraud had been previously litigated and decided in petitioner's favor in proceedings in which the petitioner and the bankrupt or his trustee, or both, had been parties and "was therefore *res judicata*".

The recital of the fact in that case further shows that the respondent, trustee, had been "authorized and directed" to take necessary steps to vacate the alleged fraudulent judgment. The trustee then took such steps in the California District Court and received an adverse decision.

In the bankruptcy proceedings to subordinate petitioner's claim, the lower Court said:

> "The Court, relying on *Pepper* v. *Litton,* 309 U. S. 295, 84 L. ed, 281, 60 S. Ct. 238, 41 Am. Bankr. Rep. (N. S.) 279, *supra,* also held that the bankruptcy court, being a court having equity powers, was not bound by the principles of *res judicata* as to issues which were not pressed before the California District Court, and that the authority of the bankruptcy court as a court of equity included the power to inquire into the validity of the claim upon which the judgment, presented as a claim against the estate, was based."

This Court then held:

> "In appropriate cases, acting upon equitable principles, it may also subordinate the claim of one creditor to those of others in order to prevent the consummation of a course of conduct by the claimant which, as to them, would be fraudulent or otherwise inequitable. (*Taylor* v. *Standard Gas & E. Co.,* 306 U. S. 307, 83 L. ed. 669, 59 S. Ct. 543, 38 Am. Bankr. Rep. (N. S.) 692, *supra; Prudence Realization Corp.* v. *Geist,* 316 U. S. 89, 86 L. ed. 1293, 62 S. Ct. 978, 48 Am. Bankr. Rep. (N. S.) 695, *supra; American Surety Co.* v. *Sampsell,* No. 142, this term, 327 U. S. 269, 66 S. Ct. 571). But we are aware of no principle of law or equity which sanctions the rejection by a federal court of the salutary principle of *res judicata* which is founded upon the generally recognized public policy that there must be some end to litigation and that when one appears in court to present his case, is fully heard, and the contested issues are decided against him, he may not later renew the litigation in another court."

And further you said:

> "In general a judgment is *res judicata* not only as to all matters litigated and decided by it, but as

> to all relevant issues which could have been but were not raised and litigated in the suit."

And finally this Court said:

> "Neither *Pepper* v. *Litton*, 308 U. S. 295, 84 L. ed. 281, 60 S. Ct. 238, 41 Am. Bankr. Rep. (N. S.) 297, *supra*, on which respondents chiefly rely, nor the other cases which they cite, sustain the contention that the bankruptcy court, in passing on the validity of creditors' claims, may disregard the principle of *res judicata*."

Respondent in this case was also authorized by the Referee to "proceed in the action now pending in the Chancery Division of the Superior Court of New Jersey wherein John S. Westervelt's Sons is plaintiff and Regency, Inc., *et al.* are defendants, and to prosecute the same either as a party plaintiff or a party defendant as that Court may order" (R. 3a).

Pursuant to such authorization, respondent joined in said action as a party defendant and joined in all the prayers of the plaintiff's (Westervelt's) complaint including the third prayer thereof "That the said defendants (the van Doorns) may be decreed to pay to complainant the full amount due and owing to it on its said judgment (R. 131a, 128a).

The sole basis for this prayer was the contention that Regency, Inc., was the corporate pocket or tool of van Doorn and repeatedly it was urged that the corporate veil should be torn aside and van Doorn be ordered personally to pay the judgment of Westervelt (R. 164a, 165a).

In the briefs on appeal from the decision in the Superior Court of New Jersey, of which briefs the Referee stated during the hearing that he would take judicial notice, the trustee and the attorneys for Westervelt repeated their

urgent insistence that the corporate veil should be torn aside from Regency, Inc. (R. 95a).

Each and every contention of corporate pocket, tool or veil raised by the respondent in this case was raised in the action in the Superior Court (R. 131a). Judge Grimshaw therein said:

> "Plaintiff urges that in addition to the judgment in favor of the trustee, there should be a money judgment against the van Doorns in favor of the plaintiff. A number of cases are cited in which the courts have pierced the corporate veil in order to prevent the perpetration of fraud. They are not in point. The plaintiff contracted with Regency, Inc. Presumably plaintiff intended to look to the assets of Regency, Inc., for the payment of its claim. Had plaintiff intended to charge the van Doorns personally it would have insisted upon having them join in the contract. All the plaintiff can ask is that the assets of Regency, Inc., shall be made available for the payment of its claim. The fact that there are other claims and that bankruptcy has intervened does not alter the situation. The prayer for a money judgment in favor of the plaintiff against Jean van Doorn and Marij van Doorn will be denied" (R. 164a-165a).

If the claims of petitioners are here subordinated, the effect will be that they will personally pay the claims of other creditors, a relief which has been denied to respondent in the state action.

## Conclusion.

**For the foregoing reasons, this petition for a writ of certiorari should be granted.**

Respectfully submitted,

Bertram K. Wolfe,
Counsel for Petitioners.

## Appendix.

Section 57g of the Bankruptcy Act (11 U. S. C. A., Sec. 93(g)) provides:

> "The claims of creditors who have received or acquired preferences, liens, conveyances, transfers, assignments or encumbrances, void or voidable under this Act, shall not be allowed unless such creditors shall surrender such preferences, liens, conveyances, transfers, assignments or encumbrances."

Section 57n of the Bankruptcy Act (11 U. S. C. A., Sec. 93(n)) provides, *inter alia:*

> "That a claim arising in favor of a person by reason of the recovery by the trustee from such person of money or property, or the avoidance by the trustee of a lien held by such person, may be filed within thirty days from the date of such recovery or avoidance, but if the recovery is by way of a proceeding in which a final judgment has been entered against such person, the claim shall not be allowed if the money is not paid or the property is not delivered to the trustee within thirty days from the date of the rendering of such final judgment, or within such further time as the court may allow."

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IN THE

# Supreme Court of the United States

OCTOBER TERM, 1951.

**No. 613.**

JEAN G. L. CASSEL VAN DOORN and
MARIJ V. CASSEL VAN DOORN,
*Petitioners,*

*v.*

WILLIAM HENIG, Trustee in Bankruptcy of
Regency, Inc., Bankrupt,
*Respondent.*

*ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT.*

## BRIEF OF RESPONDENT IN OPPOSITION.

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### Opinions Below.

The opinion of the Referee in Bankruptcy (R. 99a) is unreported. The opinion of the District Court (R. 110a) is reported in 96 F. Supp. 535. The opinion of the Circuit Court of Appeals (R. 175a) is reported in 192 F. 2d 574.

### Jurisdiction.

The judgment of the Circuit Court of Appeals was entered on December 5, 1951 (R. 176). The jurisdiction of this Court is invoked under 28 U. S. C., Section 1254 (1).

## Questions Presented.

1. Are the decisions of the Referee, the District Court and the Court of Appeals subordinating the claims of the only two officers, directors and stockholders to the claims of all other creditors such a misapplication of the principles of equity as to require that they be reversed by this Court?

2. Does a decision of a State Court in a case in which the claims of the only two stockholders, officers and directors of a corporation were not and could not have been litigated preclude a Bankruptcy Court from subordinating those claims to the payment in full of all other claims?

3. Does Section 57(g) of the Bankruptcy Act make it mandatory that after restoration of wrongfully transferred property the claims of the wrongful transferees must be allowed on a parity with other claims?

## Summary of Argument.

Petitioners have failed to show any special or important reason for review by this Court.

1. The equitable considerations involved in subordinating claims of fiduciaries, especially corporate directors, have been clearly set forth by this Court in *Pepper* v. *Litton*, 308 U. S. 295 (1939) and need no further exposition.

2. Inasmuch as the claims of the petitioners were not in any way litigated in the State Court, and, indeed, could not have been subordinated by the State Court, there is no question involving *res judicata* which would warrant review by this Court.

3. It does not follow that because Section 57g of the Bankruptcy Act provides that the claims of holders of voidable transfers shall not be allowed unless such creditors surrender such transferred property, and Section 57n of that Act gives such wrongful transferees 30 days in which to file claims arising in their favor by virtue of the recovery of such property by the Trustee, that after such restoration the Bankruptcy Court is precluded from subordinating on equitable grounds the claims of such wrongful transferees. It is obvious that such a construction, urged by petitioners, would enable the wrongful transferee, after restoration, to enjoy an invulnerability which other creditors would not enjoy. The contention of the petitioners is too obviously in error to require that it be settled by this Court. No decision in favor of the urged construction has been pointed out by petitioners.

The evidence amply supports the order of subordination, and no questionable precedents have been created by the opinions in this case.

## Statement.

(Note: All exhibits referred to herein were offered at page 15a of the record.)

This is a petition for certiorari by the only two stockholders of the bankrupt corporation, to review a judgment of the United States Court of Appeals for the Third Circuit, which affirmed an order of the United States District Court for the District of New Jersey affirming on Petition for Review the order of the Referee subordinating their claims to the payment in full of all other creditors.

Regency, Inc., the bankrupt, was incorporated in 1941 (R. 142a). It sold all its capital stock to the claimant, *Baroness Marij V. Cassel van Doorn,* wife of the claimant,

*Baron Jean G. L. Cassel van Doorn,* for $50,000 (R. 146a). All shares were issued to the Baroness except 1 share issued to the Baron and 1 share issued to Abraham H. Sles, their attorney (R. 162a).

These three stockholders were elected directors in 1941, and, except for Mr. Sles, remained so until the petition in bankruptcy was filed (R. 134a). Mr. Sles ceased to be an officer, director and stockholder after December 5, 1944 (R. 82a, 136a). After 1941 no elections of any kind were held, no stockholders' meetings were held and only two other directors' meetings were held (R. 136a). No one was elected to succeed Mr. Sles as director and secretary after his resignation in 1944 (R. 134a).

The only enterprise in which Regency ever actually engaged was the purchase of four contiguous parcels in Englewood, New Jersey, and the making of alterations and additions thereto (R. 163a). It never owned nor dealt in personal property (R. 133a). The only use to which the real estate was put was as a residence for these two claimants (R. 135a, 163a).

The purchase of the first two parcels for $50,000 exhausted the initial capital (R. 146a).

Thereafter, without corporate authorization, the Baron and Baroness incurred obligations, allegedly on behalf of the bankrupt, amounting to $320,346.14, i.e. the Baron's claim of $290,675.79, the Baroness' claim of $8,796.35, John S. Westervelt's Sons, Inc.'s claim of $18,908.37 (without interest to the date of its judgment), Frank Ackerman's claim of $1,460.63 (disputed) and the claim of William J. Beyenberg, Jr. of $505.00 (R. 141a, 150a, 151a).

No corporate books of account were kept except two sets of bank check stubs covering 9 months from December, 1941 to September, 1942 (R. 135a) and a petty cash account which accounted for $47,689.97 (R. 23a to 25a).

The records show that the following items personal to claimants are included in the claims of the van Doorns:

> Photostats of the Baron's lease at Engle Street, Tenafly (R. 25a, 26a);
>
> Travelling expenses in connection with delivering a refrigerator to the Baroness (R. 27a);
>
> Repairs to radio and flat iron for Miss Pick, secretary to the Baron (R. 28a);
>
> Two refrigerators costing $782.53 (R. 43a, 74a, 75a);
>
> Frigidaire costing $258.50 (R. 44a);
>
> Custom built range costing $482.00 (R. 44a, 73a) and
>
> Kitchen cabinets in the sum of $1,315.00 (R. 44a, 73a).

These two claimants and their family and household moved into the premises early in February, 1944 (R. 19a) and have lived there ever since. Title was then in Regency, Inc., and remained so until January 29, 1945 (R. 114a-116a). No rent was paid to Regency for their occupancy (R. 133a, 163a). During that period telephone bills and real estate taxes were paid and included in petitioners' claims (R. 45a).

On January 29, 1945, the second of the three directors' meetings took place. The Baron and Baroness were then the only directors. A resolution was then adopted ratifying the Baron's expenditures in the sum of $290,675.79 as "necessary, desirable and advantageous to this company" and authorizing the conveyance of all of the real estate (which were the entire assets of the company) to the Baron at a valuation of $129,233, that "being the true and actual value of said properties." The corporation reduced its indebtedness to the Baron by the $129,233, transferred all its property to him and gave him its demand note, without interest, for the balance of $161,442.79 (R. 136a-141a). The

admitted purpose of this transfer was to enable the Baron "to deduct annually all real estate taxes assessed against said properties and thereby effect a substantial saving in his annual Federal income tax liability" (R. 157a, 151a).

After this meeting and transfer, Regency engaged in no further activities except to defend litigation and go into bankruptcy.

The transfer was subsequently declared to be in violation of Revised Statutes of New Jersey 14:14-2, N. J. S. A. 14:14-2 and void (R. 162a-167a).

John S. Westervelt's Sons, a creditor, was contractor for part of the alterations and additions to the Regency property. It instituted suit in the Bergen County Circuit Court on November 10, 1943, for the unpaid balance due for materials and labor, and recovered a judgment on February 16, 1948. This judgment being uncollectible, Westervelt's commenced an action in the Court of Chancery of New Jersey on March 25, 1948, for the purpose of having the transfer of the property set aside and also sought to have its judgment made a personal liability of the Baron and Baroness (R. 162a-164a).

One month thereafter, on April 23rd, 1948, Regency held its third and last directors' meeting, authorizing the filing of the petition in bankruptcy, and the petition was filed on that day (R. 136a, 164a).

Westervelt's obtained an order from the Referee in Bankruptcy dated July 14, 1948, permitting it to name the Trustee in Bankruptcy a party defendant in the Chancery suit and to continue to prosecute the action (R. 2a, 3a).

Thereafter, the State Court entered judgment, setting aside the transfer and directing a conveyance to the Trustee. It denied the application for a personal judgment against the van Doorns (R. 165a-167a). In its opinion the State Court said "All the plaintiff can ask is that the assets

of Regency, Inc., shall be made available for the payment of its claim'' (R. 162a-165a). This judgment was affirmed on appeal by the Appellate Division of the Superior Court of New Jersey. 3 N. J. Super. 173, 65 A. 2d 776 (1949).

After the entry of a supplemental judgment pursuant to the mandate, the van Doorns conveyed the property to the Trustee and paid him $25,000 representing the proceeds from the sale of part of the premises in 1946, and the Baron amended his claim to include the $129,233 for which he had allowed credit at the time of the voided conveyance. He refused to deliver possession to the Trustee and appealed to the Appellate Division of the Superior Court of New Jersey from that part of the supplemental judgment ordering him to do so. This appeal resulted in a judgment of affirmance. 5 N. J. Super. 231, 68 A. 2d 755 (1949).

Thereafter, the real estate was sold by the Trustee to the claimant, Marij V. Cassel van Doorn for $90,000 (R. 77a).

The Trustee filed objections to the van Doorn claims and on October 24th, 1949 amended objections to these claims were filed (R. 4a, 9a to 13a).

The Referee allowed the van Doorn claim but subordinated them to the payment in full of all claims of other general creditors (R. 99a to 103a). This was affirmed on review by the District Court (R. 110a, 111a) and again by the Court of Appeals (R. 175a, 176a). It is to review this action that the writ of certiorari is presently sought.

## ARGUMENT.

Petitioners have failed to show any cogent reason for review by this Court. It has not been shown that there is any conflict between circuits on any question herein presented. Nor has it been demonstrated that this Court has not decided any important question raised in this case.

At most it is suggested that certain principles involved are not too clearly established and that a further review of them "may be advisable" (Petition, p. 8).

An examination of the principles involved here will show that such is not the case.

## POINT I.

### The equitable principles involved have been clearly enunciated by this Court.

It is first urged by petitioners that the principles giving rise to subordination of claims are not "too clearly defined" (Petition, p. 7).

The equitable principles which would warrant the disallowance or subordination of the claims of corporate stockholders, officers and directors are set forth clearly by this Court in the case of *Pepper* v. *Litton* (1939), 308 U. S. 295; 84 L. Ed. 281; 60 S. Ct. 238; 41 A. B. R. (N. S.) 279. They are as follows:

A. "A director is a fiduciary . . . so is a dominant or controlling stockholder or group of stockholders. . . . Their dealings with the corporation are subjected to rigorous scrutiny and where any of their contracts or engagements with the corporation is challenged, the burden is on the stockholder as director, not only to prove the good faith of the transaction but also to show its inherent fairness from the viewpoint of the corporation and those interested therein. The essence of the test is whether or not under all the circumstances, the transaction carries the earmarks of an arms length bargain. If it does not, equity will set it aside. . . . For that standard of fiduciary obligation is designed for the protection of the entire community of

interests in the corporation—creditors as well as stockholders" (308 U. S. at p. 306).

This Court cited on this point *Geddes* v. ***Anaconda Copper Min. Co.*** (1921), 254 U. S. 590; 65 L. Ed. 425; 41 S. Ct. 209.

B. The result, i.e. of disallowing or subordinating a claim "is reached where the claim asserted is void or voidable because the vote of the interested director or stockholder helped bring it into being . . ." (at p. 309).

C. The result of disallowing or subordinating a claim is also reached "where the history of the corporation shows dominancy and exploitation on the part of the claimant" (at p. 309).

D. Disallowance or subordination "is also reached where on the facts the bankrupt has been used merely as a corporate pocket of the dominant stockholder, who, with disregard of the substance or form of corporate management, has treated its affairs as his own" (at p. 309).

E. So-called loans or advances by the dominant or controlling stockholder will be subordinated to claims of other creditors and thus treated in effect as capital contributions by the stockholder not only in the foregoing types of situation (i.e. as set forth in paragraphs B, C, and D above) but also where the paid-in capital is purely nominal, the capital necessary for the scope and magnitude of the operations of the company being furnished by the stockholder as a loan" (at pp. 309-310).

F. At page 311 this Court pointed out that Litton had allowed his claim to remain dormant for years and used it only when financial difficulties arose and another creditor tried to collect a debt, and that Litton then used his claim

to impair the creditor's claim. Litton had meanwhile acquired most of the assets not for cash or other consideration of value to other creditors, but for bookkeeping entries. This Court then said:

"This alone would be a sufficient basis for the exercise by the District Court of its equitable powers in disallowing the Litton claim."

Summing these up, this Court stated:

> "Though disallowance of such claims will be ordered where they are fictitious or a sham, these cases do not turn on the existence or non-existence of the debt. Rather they involve simply the question of order of payment. At times equity has ordered disallowance or subordination by disregarding the corporate entity. That is to say, it has treated the debtor-corporation simply as a part of the stockholder's own enterprise, consistently with the course of conduct of the stockholder. But in that situation as well as in the others to which we have referred, *a sufficient consideration may be simply the violation of rules of fair play and good conscience by the claimant;* a breach of the fiduciary standards of conduct which he owes the corporation, its stockholders and creditors" (at p. 310. Emphasis supplied).

It is submitted that this Court has already clearly defined the principles involved in subordination of claims and therefore the first point urged by petitioners for a review (Petition pages 7 and 8) does not set forth a special and important reason therefor (Supreme Court Rule 38, par. 5).

## POINT II.

**There is no question of *res judicata* which would warrant review by this Court.**

The petition is based on an alleged misapplication by the courts below of the decision of this court in *Heiser* v. *Woodruff*, 327 U. S. 726, 66 Sup. Ct. 271, 90 L. Ed. 970 (1945) and upon the assumption that in that case this Court overruled its earlier decision in *Pepper* v. *Litton*, 308 U. S. 295, 60 Sup. Ct. 238, 84 L. Ed. 281, 41 A. B. R. (N. S.) 279 (1939).

The suit in the Superior Court of New Jersey, which is claimed to be a bar to the order of subordination in the Bankruptcy Court, was commenced prior to the adjudication in bankruptcy. It was instituted by a judgment creditor of Regency, Inc. for the primary purpose of having the conveyance by that corporation of all its assets to Baron van Doorn, one of the petitioners, set aside.

As a further relief, and in order to end the litigation started over four years earlier, the creditor prayed that the Baron and Baroness van Doorn, sole stockholders, directors and officers, be decreed to pay the creditor's judgment personally.

That action resulted in a decision setting aside the conveyance but denying the prayer for a money judgment against the van Doorns in favor of that creditor (R., 162a; 1 N. J. Super. 466, 63 A. (2d) 818).

An analysis of the pertinent part of the state court action shows that the issue there presented was:

Have these two people, or either of them, so handled the affairs of their wholly owned corporation that under the applicable principles of *New Jersey law* they should be made to pay from their personal funds the judgment of John S. Westervelt's Sons against their corporation?

If the state court had granted the relief sought, the petitioners would have had to pay additional money from their personal funds, if they were able to.

But the state court did not squarely answer the above question. Instead, it held that because the judgment creditor had contracted with Regency and not with the van Doorns it was barred from looking to the personal assets of the van Doorns and all it could ask "is that the assets of Regency, Inc., shall be made available for the payment of its claim" (R. 165a). It expressly ruled that the cases involving piercing the corporate veil were not in point.

It will be noted that the decision of the Bankruptcy Court is not inconsistent with the decision of the state courts, because it did in fact make the assets of *Regency* available to the creditors for the payment of their claims.

The claims of the petitioners were not involved in the action in the state court. It was not within the scope of the issues in that action to determine whether these claims were valid obligations of the bankrupt, or, if valid, in what amounts.

Furthermore, the allowance or disallowance of these claims in bankruptcy not only was not within the issues of that action but also was not within the jurisdiction of that court.

In *Pepper* v. *Litton* (above) this Court held that in that respect the jurisdiction of the bankruptcy courts is exclusive of all other courts.

Therefore, since the order of subordination was not only *not* litigated but also could not have been litigated in the state court, the doctrine of *res judicata* does not apply.

A reading of the decisions of this Court in *Heiser* v. *Woodruff* (above) and *Pepper* v. *Litton* (above) makes it

clear that the former does not overrule the latter, with reference to the effect of *res judicata.*

In any event, the present case is clearly distinguishable from the *Heiser* case. In the *Heiser* case the claimant was not a fiduciary, and his claim itself had twice previously been litigated. Here the claimants are both fiduciaries and their claims have not been previously litigated.

The courts below have correctly interpreted the applicable decisions of this Court with reference to the inapplicability of *res judicata* here, and therefore this ground does not warrant a review by this Court.

## POINT III.

**Restoration of preference does not preclude subordination.**

The third ground petitioners urge for granting the writ does not warrant extended discussion. It is, in effect, that, since they complied with the judgment of the state court and restored the wrongfully transferred property, the bankruptcy court is required by Sections 57g and 57n of the Bankruptcy Act (set forth in appendix) to allow their claims on a parity with other creditors of the same class.

A reading of the sections shows that the Act provides that without restoration the claims *cannot* be allowed, but it does not provide that with restoration the claims *must* be allowed.

It cannot logically be argued that these sections bar any consideration of subordination or disallowance of any claim by a claimant who had enjoyed a preference once the property has been restored. Such a conclusion would give a fraudulent transferee, after restoration, an invulnerability not enjoyed by other creditors, who are innocent of any preferential transfers.

The trustee did not base his objections on the ground of this transfer alone (R. 9a-13a) but merely asserted it as one of several considerations to be weighed in determining whether the petitioners should have their claims allowed on a parity with claims of other creditors.

Such a transfer was considered as a factor in *Pepper* v. *Litton* (above) and in *Goldie* v. *Cox* (C. C. A. 8th, 1942), 130 F. (2d) 695.

It is submitted that the construction of the above sections of the Bankruptcy Act urged by petitioners is too clearly erroneous to require review by this Court.

## Conclusion.

The question of subordination of claims on equitable principles generally turn on the facts of each case.

An examination of the facts in the Statement, ante, will show that there is ample evidence to support the order involved in this case.

No questionable precedent is created by any of the opinions filed in this case, and the unusual situation of dominant stockholders, as directors, causing the corporation to strip itself of its entire assets and saddle itself with a hopeless debt of $161,442.79 in the same resolution (R. 136a to 141a) for the sole avowed purpose of enabling the holder of one share of stock to deduct real property taxes on his personal income tax return (R. 151a, 157a) would undoubtedly distinguish this case from future cases.

**No cogent legal reason having been advanced for a review by this Court, and the conclusions drawn being amply supported by the evidence, it is respectfully submitted that the petition for certiorari should be denied.**

PAUL T. HUCKIN,
Attorney for WILLIAM HENIG, Trustee in Bankruptcy for Regency, Inc., Bankrupt Respondent.

## Appendix.

Section 57 (g) Bankruptcy Act, U. S. C. A. Title 11, Sec. 93g, provides:

> "(g). The claims of creditors who have received or acquired preferences, liens, conveyances, transfers, assignments or encumbrances, void or voidable under this title, shall not be allowed unless such creditors shall surrender such preferences, liens, conveyances, transfers, assignments or encumbrances."

Sub-section (n.) of the same section U. S. C. A. Title 11, Sec. 93 (n) provides in part:

> "(n.) . . . And provided further, that a claim arising in favor of a person by reason of the recovery by the trustee from such person of money or property, or the avoidance by the trustee of a lien held by such person, may be filed within thirty days from the date of such recovery or avoidance, but if the recovery is by way of a proceeding in which a final judgment has been entered against such person, the claim shall not be allowed if the money is not paid or the property is not delivered to the trustee within thirty days from the date of the rendering of such final judgment, or within such further time as the court may allow . . ."